



12 CFR Part 235

[Regulation II; Docket No. R – 1748]

RIN 7100-AG15

Debit Card Interchange Fees and Routing

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Board of Governors (Board) is seeking comment on a proposal to amend Regulation II to clarify that the requirement that each debit card transaction must be able to be processed on at least two unaffiliated payment card networks applies to card-not-present transactions, clarify the requirements that Regulation II imposes on debit card issuers to ensure that at least two unaffiliated payment card networks have been enabled for debit card transactions, and standardize and clarify the use of certain terminology.

DATES: Comments must be received on or before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

ADDRESSES: You may submit comments, identified by Docket No. R-1748, RIN 7100-AG15, by any of the following methods:

- *Agency Web Site:* <http://www.federalreserve.gov>. Follow the instructions for submitting comments at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>.
- *E-mail:* regs.comments@federalreserve.gov. Include docket number in the subject line of the message.
- *Fax:* (202) 452-3819 or (202) 452-3102.
- *Mail:* Ann E. Misback, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW, Washington, DC 20551.

All public comments are available from the Board's website at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm> as submitted, unless

modified for technical reasons or to remove personally identifiable information at the commenter's request. Accordingly, comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room 146, 1709 New York Avenue, NW, Washington, DC 20006, between 9:00 a.m. and 5:00 p.m. on weekdays.

FOR FURTHER INFORMATION CONTACT: Jess Cheng, Senior Counsel (202-452-2309), Legal Division; or Krzysztof Wozniak, Manager (202-452-3878), Elena Falcettoni, Economist (202-452-2528), or Larkin Turman, Financial Institution and Policy Analyst (202-452-2388), Division of Reserve Bank Operations and Payment Systems. Users of Telecommunication Device for Deaf (TDD) only, call (202) 263-4869.

SUPPLEMENTARY INFORMATION:

I. Introduction

A. Statutory authority

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) was enacted on July 21, 2010.¹ Section 1075 of the Dodd-Frank Act amends the Electronic Fund Transfer Act (EFTA) (15 U.S.C. 1693 et seq.) to add a new section 920 regarding interchange transaction fees for electronic debit transactions and rules for payment card transactions.²

EFTA section 920(b)(1) directs the Board to prescribe regulations that limit restrictions that issuers and payment card networks may place on the processing of an electronic debit transaction.³ An electronic debit transaction typically involves at least five

¹ Public Law 111-203, 124 Stat. 1376 (2010).

² EFTA section 920 is codified as 15 U.S.C. 1693o-2. Electronic debit transaction (or “debit card transaction”) is defined in EFTA section 920(c)(5) as a transaction in which a person uses a debit card.

³ EFTA section 920(c)(9) defines “issuer” as “any person who issues a debit card, or credit card, or the agent of such person with respect to such card.” EFTA section 920(c)(11) defines “payment card network” as “an entity that directly, or through licensed members,

parties: (i) a cardholder, (ii) the entity that issued the debit card to the cardholder (the issuer), (iii) a merchant, (iv) the merchant's depository institution (the acquirer), and (v) a payment card network.⁴ EFTA section 920(b)(1) contains two provisions with respect to issuers and payment card networks.

First, EFTA section 920(b)(1)(A) directs the Board to prescribe regulations to prohibit an issuer or payment card network from imposing exclusivity arrangements with respect to the payment card networks over which an electronic debit transaction may be processed. In particular, the statute directs the Board to prescribe regulations that forbid issuers and payment card networks from restricting the number of such networks to fewer than two unaffiliated networks ("prohibition on network exclusivity"). Absent this prohibition on network exclusivity, an issuer could enable only a single payment card network, or only two affiliated networks, to process a debit card transaction, thereby foreclosing the ability of the merchant or its acquirer to choose among multiple competing networks to process the transaction.

Second, EFTA section 920(b)(1)(B) directs the Board to prescribe regulations to prohibit an issuer or payment card network from restricting the ability of a merchant or its acquirer to choose among the networks enabled on a card when deciding how to route a debit card transaction.⁵ Specifically, the statute directs the Board to prescribe regulations

processors, or agents, provides the proprietary services, infrastructure, and software that route information and data to conduct debit card or credit card transaction authorization, clearance, and settlement, and that a person uses in order to accept as a form of payment a brand of debit card, credit card or other device that may be used to carry out debit or credit transactions." 15 U.S.C. 1693o-2.

⁴ The issuer provides the cardholder with a debit card that is enabled to process transactions over various payment card networks. The cardholder can initiate a debit card transaction at a merchant that accepts the networks enabled on the cardholder's card. To process the transaction, the acquirer routes the transaction over one of the payment card networks available on the card.

⁵ The merchant's choice of network is typically implemented by its acquirer or processor. A merchant may have preferences over the payment card networks that are available to process a debit card transaction, based on, for example, networks' interchange fees or other

that forbid issuers and payment card networks from directly or indirectly inhibiting any person that accepts debit cards for payment from directing the routing of an electronic debit transaction over any network that may process that transaction (“prohibition on routing restrictions”). Absent this prohibition on routing restrictions, an issuer or payment card network could establish rules or other restrictions that override a merchant’s routing preferences, thereby preventing the merchant or its acquirer from routing a transaction over a network with, for example, lower fees for merchants.

B. Regulation II requirements

The Board promulgated its final rule implementing the prohibitions on network exclusivity and routing restrictions in July 2011.⁶ These prohibitions under Regulation II aim to ensure that merchants or their acquirers can choose from at least two unaffiliated networks when routing debit card transactions.

Section 235.7(a) implements the prohibition on network exclusivity set out in EFTA section 920(b)(1)(A). Specifically, the provision prohibits an issuer or payment card network from directly or indirectly restricting the number of payment card networks on which an electronic debit transaction may be processed to fewer than two unaffiliated networks. To comply with the network exclusivity provisions, among other things, an issuer must allow an electronic debit transaction to be processed on at least two unaffiliated payment card networks, each of which (i) must not, by rule or policy, restrict the network’s operation to a limited geographic area, specific merchant, or particular type of merchant or transaction and (ii) must have taken steps reasonably designed to enable the network to process the electronic debit transactions that the network would reasonably expect will be

network fees. The acquirer can incorporate a merchant’s preferences when determining how to route a transaction, given the available networks.

⁶ Regulation II, Debit Card Interchange Fees and Routing, codified at 12 CFR part 235. Regulation II also implements a separate provision of EFTA section 920 regarding debit card interchange fees. The proposed revisions in this notice do not concern that provision.

routed to it.

Section 235.7(b) implements the prohibition on routing restrictions set out in EFTA section 920(b)(1)(B). Specifically, the provision prohibits any issuer or payment card network from directly or indirectly inhibiting the ability of any person that accepts or honors debit cards for payments (such as a merchant) to direct the routing of electronic debit transactions for processing over any payment card network that may process such transactions. Therefore, if an issuer has enabled a payment card network to process transactions for a particular debit card, then the issuer or payment card network may not inhibit a merchant's ability to route an electronic debit transaction over that network.

C. Overview of issue and proposed changes

At the time the Board promulgated Regulation II, for card-not-present transactions, such as online purchases, the market had not developed solutions to broadly support multiple networks over which merchants could choose to route those transactions.⁷ In the decade since the adoption of Regulation II, technology has evolved to address these barriers, and more networks have introduced capabilities to process card-not-present transactions. At the same time, card-not-present transactions have become an increasingly significant portion of all debit card transactions. Despite these developments, and in contrast to the routing choice that currently exists for card-present transactions, merchants are often not able to choose from at least two unaffiliated networks when routing card-not-present transactions, according to data collected by the Board and information from industry participants.

In light of this issue, the Board is proposing changes to Regulation II to clarify that debit card issuers should enable, and merchants should be able to choose from, at least two unaffiliated networks for card-not-present transactions. Specifically, the Board is proposing

⁷ Card-not-present transactions are those in which a cardholder initiates a card payment without physically presenting the card to a merchant. Card-not-present transactions typically involve remote commerce, such as internet, telephone, or mail-order purchases.

revisions to the commentary to Regulation II that clarify the applicability of the prohibition on network exclusivity to card-not-present transactions. These proposed revisions to the commentary clarify that card-not-present transactions are a particular type of transaction for which two unaffiliated payment card networks must be available. The Board is further proposing revisions to the rule and the commentary that clarify the responsibility of the debit card issuer in ensuring that at least two unaffiliated networks have been enabled to comply with the regulation's prohibition on network exclusivity. In addition to these changes, the Board is proposing revisions to standardize and clarify certain terms and phrases in the commentary. The Board requests comment on all proposed changes to the rule and commentary.

The proposed changes do not affect other parts of Regulation II that directly address interchange fees for certain electronic debit transactions. The Board will continue to review the regulation in light of the most recent data collected by the Board pursuant to EFTA section 920 and may propose additional revisions in the future.

II. Background on network exclusivity issues for card-not-present debit card transactions

Debit cards are used for a wide variety of payments in the United States today, involving both card-present and card-not-present transactions.⁸ Over the last decade, card-not-present transactions have become an increasingly significant type of debit card transaction. Spurred by the growth of online commerce, the number of card-not-present debit card transactions has increased rapidly in recent years, growing approximately 17 percent per year, on average, from 2009 to 2019, in contrast to the 6 percent average annual

⁸ According to the Federal Reserve Payments Study, the number of debit card payments in 2018 nearly equaled the combined number of credit card, check, and automated clearinghouse payments. See <https://www.federalreserve.gov/paymentsystems/fr-payments-study.htm>.

growth in card-present transactions over the same period.⁹ As a result of this differential growth, card-not-present transactions comprised almost 23 percent of all debit card transactions in 2019, up from slightly less than 10 percent in 2009. Recent evidence indicates that growth in card-not-present transactions has accelerated further in the Coronavirus-19 (COVID-19) environment, as consumers have shifted from in-person to remote purchases.¹⁰

Like any debit card transaction, card-not-present transactions rely on payment card networks to conduct payments. The network used to process a transaction depends primarily on the set of networks that the issuer has enabled for the transaction and the specific network that the merchant or its acquirer chooses to route the transaction out of those available.¹¹

Two types of payment card networks currently exist to process debit card transactions: single-message networks and dual-message networks.¹² Single-message networks, which developed from automated teller machine (ATM) networks, typically authorize and clear a transaction through a single message and have traditionally processed

⁹ See “2019 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions,” (2019 Data Report) available at <https://www.federalreserve.gov/paymentsystems/regii-data-collections.htm>. The data summarized in the report are collected through mandatory surveys of debit card issuers subject to the interchange fee standard in Regulation II (covered issuers) and payment card networks. Covered issuers are those with worldwide assets, including affiliates, of \$10 billion or more. The Board administers these surveys and releases biennial reports pursuant to data collection requirements in EFTA section 920.

¹⁰ For information about aggregate patterns in e-commerce, see “Latest Quarterly E-Commerce Report,” available at <https://www.census.gov/retail/index.html#ecommerce>.

¹¹ The network used to process a transaction may also depend on other factors, such as whether the merchant can support the authentication methods used by the available networks. It may also depend on the cardholder’s choice of authentication method in situations where the merchant has configured its card terminal to enable cardholder choice.

¹² Examples of dual-message and single-message networks can be found at <https://www.federalreserve.gov/paymentsystems/regii-average-interchange-fee.htm>. The “message” in a card payment involves various information related to the payment, such as the amount, the account information of the consumer and the merchant, the identities of their respective depository institutions, and the transaction environment (that is, card-present or card-not-present).

transactions authenticated using a cardholder's personal identification number (PIN).¹³ Dual-message networks, which developed from credit card systems, typically authorize and clear a transaction through two separate messages and have traditionally processed signature-authenticated transactions.¹⁴

Over time, technological developments, spurred by competition among networks to improve their capabilities and increase their transaction volumes, have allowed both single-message and dual-message networks to evolve beyond their traditional methods of authentication. Today, transactions over dual-message networks may no longer require signature authentication or may use PIN authentication. Similarly, transactions over single-message networks may no longer require PIN authentication. In addition, some networks have developed capabilities that depart from their primary messaging approach.¹⁵

There are various combinations of dual-message and single-message networks that a debit card issuer could choose to enable on its debit cards. However, the market has evolved such that, for card-present transactions, the vast majority of issuers choose to enable one dual-message network and one or more single-message networks on their cards. As a result, when a consumer and merchant interact in person, the typical debit card arrangement provides the merchant with multiple network options to route a transaction. For example, when a consumer performs an in-person debit card transaction at a grocery store, the grocer has a dual-message network and at least one single-message network as options to process the transaction. Such arrangements generally comply with Regulation II's prohibition on network exclusivity as long as at least two of those networks are unaffiliated. In that case,

¹³ Because of their historical reliance on PIN authentication, single-message debit card networks were traditionally known as "PIN debit networks."

¹⁴ Because of their historical reliance on signature authentication, dual-message debit card networks were traditionally known as "signature debit networks."

¹⁵ For example, some traditionally dual-message networks can now process certain payments using a single message. Similarly, some traditionally single-message networks can use two messages to authorize and clear some transactions.

the grocer has at least two unaffiliated networks competing to attract its debit card transactions. Regulation II's prohibition on routing restrictions further ensures that the grocer (or its acquirer) is able to choose among the available networks.

At the time Regulation II was adopted, for card-not-present transactions, the market had not developed solutions to broadly support multiple networks for each transaction. While dual-message networks had long been able to conduct card-not-present transactions, single-message networks had limited ability to process such transactions at that time. In particular, as discussed previously, single-message networks primarily processed PIN-authenticated transactions, but methods of PIN authentication for card-not-present transactions, such as PIN entry in an online setting, were not well-established. Because of this difficulty, along with the industry practice of enabling only one dual-message network on each debit card, card-not-present transactions could often only be processed on that one dual-message network at the time Regulation II was promulgated. The Board explained, however, that it expected the market to develop solutions to facilitate the use of single-message networks for card-not-present transactions in the years following the adoption of Regulation II.¹⁶

As the Board anticipated, in the decade since Regulation II was adopted, various innovations have emerged, and most single-message networks are now capable of processing card-not-present transactions.¹⁷ Data on network activity collected by the Board

¹⁶ “Debit Card Interchange Fees and Routing; Final Rule,” 76 FR 43393, 43448 (Jul. 20, 2011). Specifically, the Board expressed the view that, by requiring two unaffiliated payment card networks for each debit card transaction and removing limitations on merchant routing choice, Regulation II would promote innovation to facilitate the use of single-message networks in additional retail environments, including for online purchases.

¹⁷ For example, as noted previously, many single-message networks no longer require PIN entry for some transactions, including card-not-present transactions and low-value card-present transactions. Industry participants sometimes refer to such transactions as “PINless PIN” transactions. Technologies have also been developed to support PIN entry in different transaction environments, such as online purchases. However, the industry has not widely adopted those technologies for PIN entry.

confirm that nearly all single-message debit card networks conducted card-not-present transactions in 2019. In contrast, fewer than half of single-message networks reported such activity when Regulation II was adopted in 2011.

Despite the widespread adoption of these innovations, the volume of card-not-present transactions processed over single-message networks remains low. In particular, data collected by the Board indicate that single-message networks processed only 6 percent of all card-not-present debit card transactions in 2019. The single-message networks' low aggregate share of card-not-present transactions contrasts sharply with their share of card-present transactions, which exceeded 40 percent in 2019.¹⁸

Additional data collected by the Board and information from industry participants indicate that the low prevalence of card-not-present transactions over single-message networks may have occurred because issuers have not consistently enabled single-message networks for card-not-present transactions. According to responses to the Board's survey of covered debit card issuers, issuers that accounted for approximately 50 percent of all debit card transactions and approximately 50 percent of all card-not-present debit card transactions did not conduct any card-not-present transactions over single-message networks in 2019.¹⁹ Information from industry participants, including individual merchants, merchant trade associations, and representatives of single-message networks, corroborates that some issuers do not make single-message networks available to process card-not-present transactions on any of their cards, while some other issuers make single-message networks available to process card-not-present transactions only on a subset of their cards.

A failure by an issuer to enable at least one single-message network for card-not-present transactions, combined with the common industry approach of only enabling one dual-message network on each card, results in only one network – the dual-message network

¹⁸ See 2019 Data Report.

¹⁹ See 2019 Data Report.

– being available to process card-not-present transactions. In this situation, merchants do not have routing choice for such transactions. The Board views these practices by issuers with respect to card-not-present transactions as inconsistent with Regulation II because they restrict the number of payment card networks on which card-not-present transactions can be processed to fewer than two unaffiliated networks.

III. Section-by-Section Analysis

In light of the issues described in the previous section, the Board is proposing revisions to the commentary to Regulation II to clarify the applicability of the regulation’s prohibition on network exclusivity to card-not-present transactions. The Board is specifically proposing to clarify that card-not-present transactions are a particular type of transaction for which issuers must ensure at least two unaffiliated payment card networks have been enabled. The Board is further proposing revisions to the rule and commentary to emphasize the important role of the issuer in ensuring that at least two unaffiliated payment card networks have been enabled for each debit card transaction. The Board is also proposing revisions to the commentary to standardize and clarify the use of certain terminology and clarify the requirements that Regulation II imposes on debit card issuers.

A. Section 235.7 Limitations on payment card restrictions

The Board is proposing to amend § 235.7 of the regulation to emphasize the issuer’s role in configuring its debit cards to ensure that at least two unaffiliated networks have been enabled to comply with the regulation’s prohibition on network exclusivity. Section 235.7(a)(2) currently states that an issuer satisfies the prohibition on network exclusivity under § 235.7(a)(1) “only if the issuer allows an electronic debit transaction to be processed on at least two unaffiliated networks, each of which does not, by rule or policy, restrict the operation of the network to a limited geographic area, specific merchant, or particular type of merchant or transaction, and each of which has taken steps reasonably designed to enable the network to process the electronic debit transactions that the network would reasonably

expect will be routed to it, based on expected transaction volume.” The Board is proposing amendments to this section to reflect the role of the issuer in ensuring that the enumerated capabilities of networks are, in fact, enabled.

Specifically, § 235.7(a)(2), with the proposed amendments, would provide that an issuer satisfies the requirements of § 235.7(a)(1) only if, for every particular type of transaction (as well as every geographic area, specific merchant, and particular type of merchant) for which the issuer’s debit card can be used to process an electronic debit transaction, the *issuer has enabled* at least two unaffiliated payment card networks to process the transaction. The Board does not intend these amendments as a substantive change to the section but rather as a clarification of the existing language.

B. Appendix A to Part 235 - Official Board Commentary on Regulation II

The Board is proposing several clarifying revisions to the commentary on § 235.7. The proposed changes throughout this commentary include revisions to standardize and clarify the use of certain terminology. For example, the term “enabled” would be revised to “enabled by the issuer,” to explicitly recognize the role an issuer plays in configuring its debit cards and enabling a payment card network on a debit card, as described above. The revised terminology reflects the fact that the issuer is the entity that configures a debit card such that electronic debit transactions initiated with that card can be processed over a particular payment card network. New standardized terms would include “payment card network” (which would replace the shorthand “network” or “card network”) and “method of cardholder authentication” (which would replace variations of “authentication” or “authorization”).

Comment 235.7(a)-1 Scope of Restriction.

The Board proposes additional revisions to comment 235.7(a)-1. This comment currently clarifies the scope of the prohibition of network exclusivity under § 235.7(a), including a clarification that § 235.7(a) does not require an issuer to have two or more

unaffiliated networks available for each method of cardholder authentication. The Board proposes to update the examples of cardholder authentication methods listed in the commentary to better align with current industry practices. The proposed revisions add biometrics to the list of cardholder authentication methods in the commentary, which currently only includes signature and PIN authentication. The Board further proposes adding “or any other method of cardholder authentication that may be developed in the future” to capture cardholder authentication methods that do not yet exist and that would still be captured by Regulation II if they were to be developed. The proposed revisions also recognize instances where no method of cardholder authentication is used.

Comment 235.7(a)-2 Permitted networks.

The Board also proposes revising comment 235.7(a)-2. Comment 235.7(a)-2 currently clarifies the types of network arrangements that may be used to help satisfy the requirement in § 235.7(a) that an issuer enable two unaffiliated networks. The proposed revisions add titles to each sub-paragraph and make streamlining edits for ease of reference.

The proposed revisions also clarify that, for purposes of § 235.7, card-not-present debit card transactions are a “particular type of transaction” for which at least two unaffiliated payment card networks must be available. The Board believes this clarification is necessary in light of developments in recent years among single-message networks that have introduced capabilities to allow them to process card-not-present transactions; yet, as noted previously, information gathered by the Board suggests that certain issuers continue to enable only one dual-message payment card network for such transactions.

Finally, the Board is proposing to add a new comment 235.7(a)-2(iii) to provide clear examples of how an issuer could comply with the rule by enabling various combinations of networks so that two unaffiliated payment card networks that can each process both card-present and card-not-present transactions are available. The Board is proposing additional revisions to comment 235.7(a)-2 to further clarify the variety of

scenarios in which an issuer could enable two unaffiliated payment card networks as examples of permitted arrangements under § 235.7.

Comment 235.7(a)-7 Application of rule regardless of form factor.

The Board proposes revising comment 235.7(a)-7. Comment 235.7(a)-7 currently clarifies that the network exclusivity provisions in § 235.7 apply regardless of “form factor.” Specifically, the commentary currently provides that the prohibition on network exclusivity applies regardless of whether the debit card is issued in plastic card form and also applies to any supplemental device that is issued in connection with a plastic card, even if that plastic card fully complies with the rule. The proposed revisions replace the term “form factor” with “means of access” to better align with current industry terminology. The revisions would also add, as an example of means of access, “information stored inside an e-wallet on a mobile phone or other device,” to capture recent technological developments. The Board further proposes adding “or another means of access that may be developed in the future” to capture means of access that do not yet exist and that would still be captured by Regulation II if they were to be developed. The proposed revisions further clarify that, for any means of access that carries the debit card information, there must be at least two unaffiliated payment card networks enabled by the issuer, as required by the network exclusivity provisions in § 235.7(a). For example, if the issuer provides the cardholder with a fob in addition to a plastic card, the fob must allow transactions to be processed over at least two unaffiliated payment card networks.

IV. Regulatory Analysis

A. EFTA 904(a)

Section 904(a)(2) of the EFTA requires the Board, in prescribing regulations to carry out the purposes of EFTA section 920, to prepare an analysis of economic impact which considers the costs and benefits to financial institutions, consumers, and other users of electronic fund transfers. The analysis must address the extent to which additional

paperwork would be required, the effect upon competition in the provision of electronic fund transfer services among large and small financial institutions, and the availability of such services to different classes of consumers, particularly low income consumers.

The proposed amendments clarify Regulation II's existing requirements by emphasizing the role of the issuer in ensuring that at least two unaffiliated networks have been enabled in compliance with the regulation's network exclusivity provisions, and by clarifying that those provisions apply to card-not-present transactions. Therefore, the proposed amendments do not impose additional paperwork requirements related to reporting to the Board. With respect to the competitive effects of the proposed amendments, the proposed amendments clarify that at least two networks must be enabled for card-not-present transactions, allowing merchants or their acquirer to choose among multiple competing networks to process the transaction. Because the proposed amendments apply to all issuers regardless of their size, they are unlikely to have an effect upon competition among large and small financial institutions in the provision of electronic fund transfer services. With respect to the availability of services to different classes of consumers, particularly low-income consumers, consumers are typically unaware of the networks used to process many debit card transactions today, including card-not-present transactions where at least two unaffiliated networks are already available. Nevertheless, the effect of the proposed rule on the availability of services to consumers will likely depend on various factors, including each consumer's payment and purchase behavior, as well as market responses to the increased availability of multiple networks for card-not-present transactions. Ultimately, the costs and benefits of the proposed revisions are uncertain and will depend on the adjustments that different parties may make and the market response to the proposed rule.

In addition, EFTA section 904(a)(3) provides that in prescribing regulations to carry out the purposes of EFTA section 920, to the extent practicable, the Board shall demonstrate

that the consumer protections of the proposed regulations outweigh the compliance costs imposed upon consumers and financial institutions. The proposed rule does not relate to consumer protections, and therefore the Board cannot, at this time, determine whether the benefits to consumers exceed the possible costs to financial institutions. Additionally, the overall effects of the proposed rule on financial institutions and on consumers are dependent on a variety of factors, and the Board cannot predict the market response to the proposed rule.

The Board welcomes comment on the impact of the proposed amendments on the various participants in the debit card market and on consumers, as well as on all aspects of the analysis under EFTA section 904(a).

B. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3506; 5 CFR part 1320, Appendix A.1), the Board may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a valid Office of Management and Budget (OMB) control number. The Board reviewed the proposed rule under the authority delegated to the Board by the OMB and determined that it contains no collections of information under the PRA.²⁰ Accordingly, there is no paperwork burden associated with the proposed rule.

C. Regulatory Flexibility Act

In accordance with section 4 of the Regulatory Flexibility Act (RFA), 5 U.S.C. 601 *et seq.*, the Board is publishing an initial regulatory flexibility analysis for the proposed rule. The RFA generally requires an agency to assess the impact a rule is expected to have on small entities. The RFA requires an agency either to provide a regulatory flexibility analysis

²⁰ See 44 U.S.C. 3502(3).

or to certify that the proposed rule will not have a significant economic impact on a substantial number of small entities.

Two of the requirements of an initial regulatory flexibility analysis²¹—a description of the reasons the action is being considered and a statement of the objectives of, and legal basis for, the proposed rule—are contained in the information above. Although EFTA section 920 exempts all issuers that, together with affiliates, have assets of less than \$10 billion from the limitations on interchange transaction fees, the prohibition on network exclusivity and the prohibition on routing restrictions apply to all issuers, including small issuers. There are no reporting provisions or relevant federal rules that duplicate, overlap, or conflict with the proposed rule, and the Board is not aware of any significant alternatives to the final rule that would reduce the economic impact on Board-regulated small entities.

As discussed above in this **Supplementary Information** section, the Board is proposing to amend a particular section of the Regulation II, as well as revise portions of the commentary to the regulation, to emphasize the role of the issuer in ensuring that at least two unaffiliated networks have been enabled in compliance with the regulation's network exclusivity provisions and to clarify that the requirement that each debit card transaction must be able to be processed on at least two unaffiliated payment card networks applies to card-not-present transactions. The proposed amendments would clarify existing requirements that already apply to any person that chooses to authorize the use of a debit card to perform an electronic debit transaction, regardless of that issuer's size. The Board does not intend these amendments to be an expansion of coverage to any additional small entities that were not already subject to the rule.

Another requirement for the initial regulatory flexibility analysis is a description of, and where feasible, an estimate of, the number of small entities to which the proposed rule

²¹ 5 U.S.C. 603(b).

will apply. Under regulations issued by the Small Business Administration, a small entity includes a depository institution, bank holding company, savings and loan holding company, and credit card issuer with total assets of \$600 million or less and trust companies with total annual receipts of \$41.5 million or less.²² According to Call Reports and other Board reports, there were approximately 472 state member banks, 2,925 bank holding companies, 132 savings and loan holding companies, and 16 Edge and agreement corporations that are small entities.²³

As discussed in preceding sections, the proposed amendments are intended to clarify the regulation's existing prohibition on network exclusivity, and the Board does not intend these proposed amendments to be an expansion of coverage to any additional small entities that were not already subject to the rule. For these reasons, the Board believes that this proposed rule will not have a significant economic impact on a substantial number of small entities. The Board welcomes comment on all aspects of its analysis. In particular, the Board requests that commenters describe the nature of any impact on small entities and provide empirical data to illustrate and support the extent of the impact.

D. Solicitation of Comments of Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act (Pub. L. No. 106-102, 113 Stat. 1338, 1471, 12 U.S.C. 4809) requires the federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The Board has sought to present the proposed rule in a simple and straightforward manner and invites comment on the use of plain language and whether any part of the proposed rule could be more clearly stated.

List of Subjects in 12 CFR Part 235

²² See 13 CFR 121.201; 84 FR 34261 (July 18, 2019).

²³ State member bank data are derived from March 31, 2020 Call Reports. Data for bank holding companies and savings and loan holding companies are derived from the June 30, 2020, FR Y-9C and FR Y-9SP. Data for Edge and agreement corporations are derived from the December 31, 2019 and March 31, 2020, FR-2086b.

Banks, banking, Debit card routing, Electronic debit transactions, Interchange transaction fees.

Authority and Issuance

For the reasons set forth in the preamble, the Board is proposing to amend Regulation II, 12 CFR part 235, as follows:

PART 235 – DEBIT CARD INTERCHANGE FEES AND ROUTING (REGULATION II)

1. The authority citation for part 235 continues to read as follows:

Authority: 15 U.S.C. 1693o–2.

2. Section 235.7 is amended by revising paragraph (a)(2) to read as follows:

§ 235.7 Limitations on payment card restrictions.

(a) * * *

(2) *Permitted arrangements.* An issuer satisfies the requirements of paragraph (a)(1) of this section only if, for every geographic area, specific merchant, particular type of merchant, and particular type of transaction for which the issuer's debit card can be used to process an electronic debit transaction, such issuer enables at least two unaffiliated payment card networks to process an electronic debit transaction, and where each of these networks has taken steps reasonably designed to be able to process the electronic debit transactions that it would reasonably expect will be routed to it, based on expected transaction volume.

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3. Amend Appendix A to Part 235 – Official Board Commentary on Regulation II by:

- a. Revising paragraph 7(a);
- b. Revising paragraphs 7(b)1., (b)(2), and (b)(5).

The revisions read as follows:

APPENDIX A TO PART 235 – OFFICIAL BOARD COMMENTARY ON REGULATION II

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SECTION 235.7 LIMITATIONS ON PAYMENT CARD RESTRICTIONS

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7(a) Prohibition on Network Exclusivity

1. *Scope of restriction.* Section 235.7(a) requires an issuer to configure each of its debit cards so that each electronic debit transaction initiated with such card can be processed on at least two unaffiliated payment card networks. In particular, section 235.7(a) requires this condition to be satisfied for every geographic area, specific merchant, particular type of merchant, and particular type of transaction for which the issuer's debit card can be used to process an electronic debit transaction. As long as the condition is satisfied for each such case, § 235.7(a) does not require the condition to be satisfied for each method of cardholder authentication (e.g., signature, PIN, biometrics, any other method of cardholder authentication that may be developed in the future, or the lack of a method of cardholder authentication). For example, it is sufficient for an issuer to issue a debit card that can process signature-authenticated transactions only over one payment card network and PIN-authenticated transactions only over another payment card network, as long as the two payment card networks are not affiliated and each network can be used to process electronic debit transactions for every geographic area, specific merchant, particular type of merchant, and particular type of transaction for which the issuer's debit card can be used to process an electronic debit transaction.

2. *Permitted networks.*

i. *Network volume capabilities.* A payment card network could be used to satisfy the requirement that an issuer enable two unaffiliated payment card networks for each electronic debit transaction if the network was either (a) capable of processing the volume of electronic debit transactions that it would reasonably expect to be routed to it or (b)

willing to expand its capabilities to meet such expected transaction volume. If, however, the network's policy or practice is to limit such expansion, it would not qualify as one of the two unaffiliated payment card networks.

ii. *Reasonable volume expectations.* One of the steps a payment card network can take to form a reasonable expectation of its transaction volume is to consider factors such as the number of cards expected to be issued that are enabled by an issuer on the network and expected card usage patterns.

iii. *Examples of permitted arrangements.* For every geographic area (e.g., New York State), specific merchant (e.g., a specific fast food restaurant chain), particular type of merchant (e.g., fast food restaurants), and particular type of transaction (e.g., card-not-present transaction) for which the issuer's debit card can be used to process an electronic debit transaction, an issuer must enable at least two unaffiliated payment card networks, but those payment card networks do not necessarily have to be the same two payment card networks for every transaction.

A. *Geographic area:* An issuer complies with the rule only if, for every geographic area in which the issuer's debit card can be used to process an electronic debit transaction, the issuer enables at least two unaffiliated payment card networks. For example, an issuer could comply with the rule by enabling two unaffiliated payment card networks that can each process transactions in all 50 U.S. states. Alternatively, the issuer could comply with the rule by enabling three unaffiliated payment card networks, A, B, and C, where network A can process transactions in all 50 U.S. states, network B can process transactions in the 48 contiguous United States, and network C can process transactions in Alaska and Hawaii.

B. *Particular type of transaction:* An issuer complies with the rule only if, for every particular type of transaction for which the issuer's debit card can be used to process an electronic debit transaction, the issuer enables at least two unaffiliated payment card

networks. For example, an issuer could comply with the rule by enabling two unaffiliated payment card networks that can each process both card-present and card-not-present transactions. Alternatively, the issuer could comply with the rule by enabling three unaffiliated payment card networks, A, B, and C, where network A can process both card-present and card-not-present transactions, network B can process card-present transactions, and network C can process card-not-present transactions.

3. Examples of prohibited network restrictions on an issuer's ability to contract with other payment card networks. The following are examples of prohibited network restrictions on an issuer's ability to contract with other payment card networks:

i. Network rules or contract provisions limiting or otherwise restricting the other payment card networks that an issuer may enable on a particular debit card, or network rules or contract provisions that specify the other networks that an issuer may enable on a particular debit card.

ii. Network rules or guidelines that allow only that payment card network's (or its affiliated networks') brand, mark, or logo to be displayed on a particular debit card, or that otherwise limit the ability of brands, marks, or logos of other payment card networks to appear on the debit card.

4. Network logos or symbols on card not required. Section 235.7(a) does not require that a debit card display the brand, mark, or logo of each payment card network over which an electronic debit transaction may be processed. For example, the rule does not require a debit card that an issuer enables on two or more unaffiliated payment card networks to bear the brand, mark, or logo of each such payment card network.

5. Voluntary exclusivity arrangements prohibited. Section 235.7(a) requires that an issuer enable at least two unaffiliated payment card networks to process an electronic debit transaction, even if the issuer is not subject to any rule of, or contract or other agreement

with, a payment card network requiring that all or a specified minimum percentage of electronic debit transactions be processed on the network or its affiliated networks.

6. *Affiliated payment card networks.* Section 235.7(a) does not prohibit an issuer from enabling two affiliated payment card networks among the networks on a particular debit card, as long as at least two of the networks that can be used to process each electronic debit transaction are unaffiliated.

7. *Application of rule regardless of means of access.* The network exclusivity provisions in § 235.7(a) require that a debit card be enabled by the issuer on at least two unaffiliated payment card networks for each means of access. The means of access that carries the debit card information could be a plastic card, a supplemental device such as a fob, information stored inside an e-wallet on a mobile phone or other device, or another means of access that may be developed in the future.

7(b) Prohibition on Routing Restrictions

1. *Relationship to the network exclusivity restrictions.* An issuer or payment card network is prohibited from inhibiting a merchant's ability to direct the routing of an electronic debit transaction over any of the payment card networks that the issuer has enabled on that particular debit card. The rule does not permit a merchant to route the transaction over a payment card network that the issuer did not enable to process transactions using that debit card.

2. *Examples of prohibited merchant restrictions.* The following are examples of issuer or network practices that would inhibit a merchant's ability to direct the routing of an electronic debit transaction and that are therefore prohibited under § 235.7(b):

i. Prohibiting a merchant from encouraging or discouraging a cardholder's use of a particular method of cardholder authentication, for example prohibiting merchants from favoring a cardholder's use of one cardholder authentication method over another, or from

discouraging the cardholder's use of any given cardholder authentication method, as further described in comment 7(a)-1.

ii. Establishing network rules or designating issuer priorities directing the processing of an electronic debit transaction on a specified payment card network or its affiliated networks, or directing the processing of the transaction away from a specified payment card network or its affiliates, except as (i) a default rule in the event the merchant, or its acquirer or processor, does not designate a routing preference, or (ii) if required by state law.

iii. Requiring a specific payment card network to be used based on the means of access presented by the cardholder to the merchant.

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5. No effect on network rules governing the routing of subsequent transactions.

Section 235.7 does not supersede a payment card network rule that requires a chargeback or return of an electronic debit transaction to be processed on the same network that processed the original transaction.

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By order of the Board of Governors of the Federal Reserve System.

Ann Misback,

Secretary of the Board.

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